

The State Lottery Commission of Indiana

*Financial Statements as of and for the
Years Ended June 30, 2006 and 2005,
Required Supplementary Information, and
Independent Auditors' Report*

THE STATE LOTTERY COMMISSION OF INDIANA

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INDEPENDENT AUDITORS' REPORT

To the State Lottery Commission of Indiana:

We have audited the accompanying statements of net assets of the State Lottery Commission of Indiana (the "Commission") as of June 30, 2006 and 2005, and the related statements of revenues, expenses and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of the management of the Commission. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial statement audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Commission's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Commission as of June 30, 2006 and 2005, and the changes in its net assets and the cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis and Required Supplementary Information, as listed in the table of contents, is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Commission's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information, and we do not express an opinion on it.

In accordance with Government Auditing Standards, we have also issued our report dated October 11, 2006, on our consideration of the Commission's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audits.



October 11, 2006

Management Discussion and Analysis

The management of The State Lottery Commission of Indiana ("Commission") offers readers of the Commission's annual financial report this narrative overview of its performance during the fiscal year ended June 30, 2006. Please read it in conjunction with the financial statements, which follow this section.

Financial Highlights

- Fiscal year 2006 ("FY06") ticket sales were \$816 million, an increase of approximately \$77 million or 10% over fiscal year 2005 ("FY05"). The increase in sales is primarily attributable to a \$34 million increase in scratch-off ticket sales, a \$39 million increase in Powerball tickets sales and a \$5 million increase in Hoosier Lotto sales.
- Prize expenses for FY06 increased \$38 million over FY05. The 8% increase in prize expenses represents the increased expense associated with the \$77 million increase in sales revenues as mentioned above.
- Direct gaming expense, which includes ticket printing costs, advertising and promotion, retailer commissions, on-line professional services, and Instant Ticket Vending Machine (ITVM) services, increased \$6 million over FY 05. These increases are primarily related to increases in retailer commissions of approximately \$5 million in instant ticket printing and \$2 million of line vendor expenses. Such increases were attributable to increased instant ticket and on line game sales.
- Other operating expenses, which include salaries and benefits and general and administrative expenses in FY 06 remained flat compared to those for FY05.
- Non-operating revenues, net of expenses, decreased \$3 million over FY 05. While interest income increased by \$2 million over FY 05, it was offset by a \$3.7 million unrealized loss on the fair market value adjustment of U.S. Treasury securities held by the Commission to fund long-term prizes.
- FY06 operating income of \$218 million represents a 15% increase over FY05.

Overview of the Financial Statements

The Commission is accounted for as an enterprise fund, reporting transactions using the accrual basis of accounting similar to a business entity. This discussion and analysis is intended to serve as an introduction to the Commission's financial statements, along with corresponding note disclosures and other supplementary information.

By law, the Commission is required each quarter to transfer all of its surplus revenues to the State of Indiana. As a result, the net assets of the Commission consist of an amount set aside for the future cash flow needs of the Commission and the net book value of funds invested in capital assets. To assess the Commission's financial position and financial health, the reader of these financial statements should pay particular attention to changes in the components of assets and liabilities as set forth in the statement of net assets, and in changes in operating revenues, expenses and distributions as set forth in the statement of revenues, expenses and changes in net assets. In addition, the statement of cash flows is intended to provide information about the cash receipts, cash payments and net changes in cash resulting from operations, financing and investing activities.

Financial Analysis of the Commission

Net Assets and Change in Net Assets

Net assets represent the difference between total assets and total liabilities. Because the Commission is required by law to make quarterly transfers of its surplus revenues to the State of Indiana, the change in net assets does not necessarily reflect the results of the Commission's operating activities.

Net Assets (in millions of dollars)

	June 30,		
	2006	2005	Change
Current assets	\$ 118	\$ 101	\$ 17
Restricted assets	9	9	-
Long-term investments	66	70	(4)
Capital assets—net	3	3	-
Total assets	<u>196</u>	<u>183</u>	<u>13</u>
Current liabilities	121	110	11
Long-term liabilities	68	68	-
Total liabilities	<u>189</u>	<u>178</u>	<u>11</u>
Net assets			
Unrestricted	4	2	2
Invested in capital assets	3	3	-
Total net assets	<u>\$ 7</u>	<u>\$ 5</u>	<u>\$ 2</u>

Assets

A FY06 increase in assets was primarily the result of an increase in cash and cash equivalents from \$58 million to \$78 million at June 30, 2006. The increase is primarily due to an increase of \$20 million in net income for the fourth quarter of FY06 compared to FY05.

Liabilities

Current liabilities increased by \$11 million primarily as a result of increased sales and net income and the timing of the related payments to winners and the State Treasurer.

Net assets

Net assets consist of unrestricted income retained for the future cash flow needs of the Commission and capital assets. The Commission's total net assets at June 30, 2006 and 2005 were \$7 million and \$5 million, respectively.

Sales and Prize Expense
(in millions of dollars)

	Scratch-Off			Pull-Tab		
	2006	2005	Change	2006	2005	Change
Operating Revenues	\$ 504.9	\$ 470.4	\$ 34.5	16.7	\$ 19.3	\$ (2.6)
Game Prizes	335.0	314.6	20.4	10.9	12.6	(1.7)
Gross Margin	<u>169.9</u>	<u>\$ 155.8</u>	<u>\$ 14.1</u>	<u>5.8</u>	<u>\$ 6.7</u>	<u>\$ (0.9)</u>
	Powerball			Hoosier Lotto		
	2006	2005	Change	2006	2005	Change
Operating Revenues	\$ 159.8	\$ 120.3	\$ 39.5	65.5	\$ 60.9	\$ 4.6
Game Prizes	76.4	56.4	20.0	34.6	32.7	1.9
Gross Margin	<u>83.4</u>	<u>\$ 63.9</u>	<u>\$ 19.5</u>	<u>30.9</u>	<u>\$ 28.2</u>	<u>\$ 2.7</u>
	Daily Draw Games			Other		
	2006	2005	Change	2006	2005	Change
Operating Revenues	\$ 67.0	\$ 67.5	\$ (0.5)	2.4	\$ 1.2	\$ 1.2
Game Prizes	31.8	31.3	0.5	1.4	0.6	0.8
Gross Margin	<u>35.2</u>	<u>\$ 36.2</u>	<u>\$ (1.0)</u>	<u>1.0</u>	<u>\$ 0.6</u>	<u>\$ 0.4</u>
	Total					
	2006	2005	Change			
Operating Revenues	\$ 816.3	\$ 739.6	\$ 76.7			
Game Prizes	490.1	448.2	41.9			
Gross Margin	<u>\$ 326.2</u>	<u>\$ 291.4</u>	<u>\$ 34.8</u>			

The table above compares FY06 and FY05 sales, prize expense and gross margin for major lottery game categories. FY06 sales increased in the scratch-off, Powerball and Hoosier Lotto product lines. Sales decreased for pull-tab games and remained relatively comparable for the daily draw games. The "Other" category includes the Raffle and TV Bingo on-line draw games for FY05 and includes Raffle, TV Bingo and Mix & Match for FY 06. TV Bingo was cancelled in the fourth quarter of FY 06 and the Mix & Match game was introduced in May of 2006. Gross margins generally increased or decreased relative to changes in game sales.

The FY06 increase in scratch-off ticket sales reflects the continuation of increased public awareness of such games and the continued effort to promote play in these games. The Commission has continually increased placement of the \$2 and higher priced games in retail locations. Advertising has been focused on the \$2 and \$5 price point games with a corresponding increase in sales.

Powerball is a multi-state lotto game offering large jackpot prizes. The Commission participates in this game along with 30 other United States lotteries, including the District of Columbia and the U.S. Virgin Islands. Powerball sales increased in FY06 by approximately \$40 million to \$160 million. The primary reason for the

increase was two record jackpots in FY 06. Sales were also enhanced due to an increase in the power play component of the game and increased advertising.

Hoosier Lotto is a smaller lotto game available only in Indiana. Sales increased during FY06 by approximately \$5 million. The increase in sales is primarily due to larger average jackpots being awarded throughout FY06 as compared to FY05.

The “Daily Draw Games” consists of the Daily 3, Daily 4 and Lucky 5 games. The Daily Draw Games have slightly decreasing sales levels. The decrease in prize is proportionate to the decrease in sales.

Prize Expense

In general, prize expense by game will increase or decrease from year to year in proportion to the increase or decrease in ticket sales for the corresponding game. However, prize expense can also be impacted by the luck of the draw or by changes to the game design. Prize expense for the Hoosier Millionaire game show, which was cancelled in December 2005, is unrelated to ticket sales.

Total prize expense in FY06 of \$493 million represents an 8% increase over FY05 prize expense of \$455 million. Notable variances in prize expense are discussed below.

- FY06 scratch-off game prize expense increased 8% or \$26 million. This is reflective of increased sales which increased by \$35 million in FY06.
- On-line game prize expense increased 19% or \$23 million in FY06 as compared to FY05. Such increase is directly related to the increased sales of the Powerball and Hoosier Lotto tickets as discussed previously.
- FY06 prize expense for the Hoosier Millionaire game show decreased from \$7 million to \$3 million as the Hoosier Millionaire game show was cancelled in the second quarter of FY06.

Other Operating Expenses

Other Operating Expenses for the year ended June 30, (in millions of dollars)

	<u>2006</u>	<u>2005</u>	<u>Change</u>
Advertising & Promotions	\$ 9	\$ 10	\$ (1)
Retailer commissions	57	51	6
On-line professional services	9	9	0
ITVM lease and courier services	4	3	1
Ticket printing costs	9	8	1
Salaries, wages, and benefits	12	13	(1)
General and administrative	5	5	0
Total other operating expenses	<u>\$ 105</u>	<u>\$ 99</u>	<u>\$ 6</u>

Overall, other operating expenses remained consistent from FY05 to FY06. The fluctuation of \$6 million in Retailer commissions is directly related to the increase in overall ticket sales as retailers earn a commission on each ticket sold.

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THE STATE LOTTERY COMMISSION OF INDIANA

STATEMENTS OF NET ASSETS AS OF JUNE 30, 2006 AND 2005

	2006	2005
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 77,842,704	\$ 57,834,783
Investments—current portion	7,024,000	9,668,378
Accounts receivable—net	29,301,475	30,337,865
Prepaid expenses	3,087,160	2,448,572
Accrued interest receivable	67,157	200,033
Ticket inventory	348,883	319,242
Total current assets	<u>117,671,379</u>	<u>100,808,873</u>
NONCURRENT ASSETS:		
Long-term investments—less current portion above	65,889,955	70,419,514
Restricted assets	8,992,723	9,224,755
Capital assets—net	<u>2,806,630</u>	<u>2,994,302</u>
Total noncurrent assets	<u>77,689,308</u>	<u>82,638,571</u>
TOTAL	<u>\$ 195,360,687</u>	<u>\$ 183,447,444</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Accounts payable:		
State	\$ 51,594,890	\$ 45,049,125
Trade	7,729,426	7,287,869
Current portion of prize liability	58,067,505	55,459,250
Deferred revenue	1,059,373	647,046
Other accrued expenses	<u>2,809,780</u>	<u>1,773,335</u>
Total current liabilities	121,260,974	110,216,625
LONG-TERM LIABILITIES—Prize liability less current portion	<u>67,512,080</u>	<u>68,230,819</u>
Total liabilities	<u>188,773,054</u>	<u>178,447,444</u>
NET ASSETS:		
Unrestricted	3,781,003	2,005,698
Invested in capital assets	<u>2,806,630</u>	<u>2,994,302</u>
Total net assets	<u>6,587,633</u>	<u>5,000,000</u>
TOTAL	<u>\$ 195,360,687</u>	<u>\$ 183,447,444</u>

See notes to financial statements.

THE STATE LOTTERY COMMISSION OF INDIANA

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	2006	2005
OPERATING REVENUES:		
Instant ticket sales—net	\$ 521,604,691	\$ 489,736,650
On-line ticket sales	<u>294,757,423</u>	<u>249,896,405</u>
Total operating revenues	<u>816,362,114</u>	<u>739,633,055</u>
OPERATING EXPENSES:		
Game expenses:		
Instant game prizes	345,848,926	327,176,941
On-line games prizes	144,199,439	121,056,817
Television game show prizes	3,078,444	7,098,408
Retailer commissions	56,734,312	51,401,509
Ticket printing costs	8,683,043	7,851,976
Advertising and promotion	8,837,971	10,060,953
On-line professional services	9,629,621	8,461,606
ITVM lease and courier services	<u>3,707,991</u>	<u>3,346,522</u>
Total game expenses	<u>580,719,747</u>	<u>536,454,732</u>
OTHER OPERATING EXPENSES:		
Salaries, wages, and benefits	12,420,682	13,002,805
General and administrative	<u>4,807,247</u>	<u>4,419,623</u>
Total other operating expenses	<u>17,227,929</u>	<u>17,422,428</u>
Total operating expenses	<u>597,947,676</u>	<u>553,877,160</u>
OPERATING INCOME	<u>218,414,438</u>	<u>185,755,895</u>
NONOPERATING REVENUES (EXPENSES):		
Interest income	3,191,607	1,356,850
Net (decrease) increase in fair value of investments	(3,730,714)	2,552,513
Other income (expense)	<u>204,192</u>	<u>(624,261)</u>
Total nonoperating revenues (expenses)	<u>(334,915)</u>	<u>3,285,102</u>
NET INCOME PRIOR TO DISTRIBUTIONS	<u>218,079,523</u>	<u>189,040,997</u>
DISTRIBUTIONS:		
Distributions to the State	(164,897,000)	(143,880,204)
Distributions to be paid to the State	<u>(51,594,890)</u>	<u>(45,049,125)</u>
Total distributions	<u>(216,491,890)</u>	<u>(188,929,329)</u>
CHANGES IN NET ASSETS	1,587,633	111,668
NET ASSETS—Beginning of year	<u>5,000,000</u>	<u>4,888,332</u>
NET ASSETS—Ending of year	<u>\$ 6,587,633</u>	<u>\$ 5,000,000</u>

See notes to financial statements.

THE STATE LOTTERY COMMISSION OF INDIANA

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from ticket sales	\$ 817,750,417	\$ 735,735,612
Payments to ticket winners	(491,237,293)	(442,931,420)
Payments to employees	(11,384,237)	(13,437,124)
Payments of suppliers	<u>(91,389,121)</u>	<u>(82,482,674)</u>
Net cash provided by operating activities	<u>223,739,766</u>	<u>196,884,394</u>
CASH FLOWS FROM NONCAPITAL AND RELATED FINANCING ACTIVITIES:		
Distributions to the State	(209,946,125)	(189,739,422)
Other income (expense)	204,192	(624,261)
Net decrease in restricted assets	<u>232,032</u>	<u>515,739</u>
Net cash used in noncapital and related financing activities	<u>(209,509,901)</u>	<u>(189,847,944)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchase of fixed assets	(1,089,317)	(697,702)
Proceeds from the sale of fixed assets	<u>99,667</u>	<u>15,866</u>
Net cash used in capital and related financing activities	<u>(989,650)</u>	<u>(681,836)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net proceeds (purchases) of investments	3,443,223	(8,713,458)
Interest income	<u>3,324,483</u>	<u>1,300,372</u>
Net cash provided by (used in) investing activities	<u>6,767,706</u>	<u>(7,413,086)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	20,007,921	(1,058,472)
CASH AND CASH EQUIVALENTS—Beginning of year	<u>57,834,783</u>	<u>58,893,255</u>
CASH AND CASH EQUIVALENTS—End of year	<u>\$ 77,842,704</u>	<u>\$ 57,834,783</u>

(Continued)

THE STATE LOTTERY COMMISSION OF INDIANA

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	2006	2005
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	\$ 218,414,438	\$ 185,755,895
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	1,237,736	1,604,739
Change in provision for doubtful accounts	59,034	3,630
Change in provision for ticket returns	321,008	(67,156)
Gain on sale of fixed assets	(60,414)	45,247
Changes in assets and liabilities:		
Accounts receivable	656,348	(4,082,395)
Instant ticket inventory	(29,641)	(5,205)
Prepaid expenses and other assets	(638,588)	(1,212,555)
Accounts payable—trade	441,557	2,548,309
Deferred revenue	412,327	327,458
Other accrued expenses	1,036,445	(434,319)
Prize liability	<u>1,889,516</u>	<u>12,400,746</u>
Net cash provided by operating activities	<u>\$ 223,739,766</u>	<u>\$ 196,884,394</u>
SCHEDULE OF NONCASH INVESTING, CAPITAL, AND RELATED FINANCING ACTIVITIES—		
Net (decrease) increase in fair value of investments	<u>\$ (3,730,714)</u>	<u>\$ 2,552,513</u>

See notes to financial statements.

(Concluded)

THE STATE LOTTERY COMMISSION OF INDIANA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

1. REPORTING ENTITY

The State Lottery Commission of Indiana (the “Commission”) was established by Public Law No. 341, as amended, as listed in Indiana Code Section 4, Article 30 in May 1989 (“Lottery Article”). The Commission is a component unit of the State of Indiana (the “State”) and is reported as an enterprise fund in the State’s Comprehensive Annual Financial Report (“CAFR”).

The Commission has introduced various draw games since its inception, including Hoosier Lotto, Powerball, Daily 3, Daily 4, Lucky 5, TV Bingo, Mix & Match, various Raffle games, and various scratch-off and pull-tab ticket games. The Commission discontinued TV Bingo in April 2006.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting—The Commission’s financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (“generally accepted accounting principles”). Under this method, revenues are recognized when earned and expenses are recognized when incurred. In accordance with Statement of Governmental Accounting Standards No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Commission is required to follow all applicable Governmental Accounting Standards Board (“GASB”) pronouncements.

Estimates—The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition—Scratch-off and pull-tab ticket revenue, less an allowance for returns, is recognized at the time tickets are shipped to the Commission’s licensed retailers. Ticket revenue for draw games is recognized in the period in which tickets sold to the playing public become eligible for a drawing. Certain scratch-off ticket games include free ticket prizes that entitle the holder to exchange one ticket for another of equal value. The selling price of free tickets reduces scratch-off ticket revenue when tickets are issued to retailers.

Cash and Cash Equivalents—Cash and cash equivalents consist of cash on deposit and short-term, highly liquid investments, with original maturity dates of three months or less. Included in cash and cash equivalents are investments in direct obligations of the U.S. government or government agencies, perfected repurchase agreements, AAA/AA short-term commercial paper or various money market funds composed exclusively of investment vehicles previously described. At times, cash deposits may be in excess of the federally insured limits.

Investments—The treasurer of the State, on behalf of the Commission, is permitted to invest Commission funds in direct obligations of the U.S. Treasury or insurance annuities to fund future installment prize obligations. Investments are recorded at fair value, except for the insurance annuities, at June 30, 2006 and 2005. The insurance annuities are considered to be nonparticipating interest-earning contracts and are carried at cost.

Accounts Receivable, net—Accounts receivable represent proceeds due from retailers for net ticket sales, less commissions and prizes redeemed by retailers. Accounts receivable is reduced by an allowance for ticket returns and an allowance for doubtful accounts. Allowance for ticket returns is based on historical experience associated with scratch-off and pull-tab game ticket returns and was \$4,025,471 and \$2,086,291 as of June 30, 2006 and 2005, respectively. Allowance for doubtful accounts is based on management's estimate of retailer receivables that will not be collected and was \$64,034 and \$5,000 as of June 30, 2006 and 2005, respectively.

Capital Assets—Capital assets are stated at cost. Capital assets are defined as assets that have a useful life of more than one year and a unit cost of more than \$1,000. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Vehicles, data processing equipment, and software are depreciated over three years; all other assets are depreciated over five years. Depreciation expense was \$1,237,736 and \$1,604,739 for the years ended June 30, 2006 and 2005, respectively.

Ticket Inventory—Ticket inventory consists of certain scratch-off tickets and all pull-tabs purchased by the Commission under an agreement for new games that are not yet on sale to retailers. These inventories are carried at cost, using the specific identification method. Tickets are expensed upon shipment to licensed retailers.

The Commission has an agreement with its primary scratch-off ticket vendor whereby the Commission only pays for scratch-off tickets issued to and sold by Commission retailers. Any scratch-off tickets not issued to retailers for sale or any tickets not sold by retailers are not paid for by the Commission. Therefore, the Commission does not have any risk of loss in the event the tickets become damaged or lost and tickets are not treated as inventory by the Commission.

Prize Liability—Prize liability includes an estimate of sold and unclaimed scratch-off, pull-tab and draw game winners as of June 30, 2006 and 2005, as well as installment amounts payable to past scratch-off, pull tab, draw game, and game show winners. Installment prizes are recorded at a discount based on interest rates that range from approximately 3% to 6%, which is reflective of the interest rate earned on the investments held to fund the related liabilities.

For scratch-off and pull-tab games, a liability is recorded when the Commission ships the tickets to the licensed retailers. The accrual is based on the specified prize payout structure established for each game. Instant game prizes must be claimed within 60 days after the declared end-of-game date or they will be forfeited. The liability for daily mid-day and evening draw games is determined based on the actual winning numbers drawn and the number of wagers placed for each draw date. The liability for the Hoosier Lotto is determined by the level of jackpot that could be won on a given draw date. All draw game prizes must be claimed within 180 days of the date of the selection event or they will be forfeited. All unclaimed prize money is added to a pool from which future prizes may be awarded or from which the cost of prize promotions can be paid. Unclaimed prize money at June 30, 2006 and 2005 of \$275,089 and \$440,167, respectively, is included in current portion of prize liability in the accompanying statements of net assets.

Net Assets—As stated in the Lottery Article, funds in excess of the amounts necessary to pay prizes and expenses for the operation of the Commission are to be distributed quarterly per a statutory schedule to the State treasurer. The Commission has set aside amounts that it estimates are necessary to meet future cash flow needs of the Commission until the next transfer to the State treasurer. These amounts have been reflected in the accompanying financial statements as unrestricted net assets.

The Lottery Article requires that the State treasurer distribute \$30 million annually to the Indiana State Teacher's Retirement Fund to pay a portion of the current pension obligations, and \$30 million annually to the State Pension Relief Fund to assist cities and towns in the payment of current and future pension obligations. The balance of the amount distributed to the State Treasurer is deposited into the State's Build Indiana Fund, to be distributed to state and local capital projects and for the Lottery/Gaming Surplus Account. Distributions to the State's Build Indiana Fund totaled \$149,946,126 and \$129,739,422 for the years ended June 30, 2006 and 2005, respectively.

Net assets invested in capital assets consist of capital assets, net of accumulated depreciation.

Commissions and Bonuses—Retailers earn a 6.0% sales commission on draw game tickets and a 5.5% sales commission on scratch-off and pull-tab game tickets. Retailers earn a 1.0% cashing commission for redeeming winning tickets and the lesser of 1.0% or \$100,000 for selling winning jackpot tickets. Additionally, retailers are eligible for a quarterly bonus based on their scratch-off and pull tab sales over the preceding 13-week period.

Contractor Fees—The Commission has contracted with Scientific Games, Inc. ("Sci Games") for the majority of its gaming systems and supplies.

The Commission entered into a contract, with an effective date of January 19, 1999, with Sci Games for the operation of the gaming network that consists of approximately 4,000 instant and on-line retailer ticket terminals and associated software. Effective August 12, 2004, the contract was amended changing the fee percentage from 3.94% of gross on-line ticket revenue to 3.00% of gross on-line ticket revenue.

The Commission entered into a contract, with an effective date of April 24, 2001, with Sci Games for the printing and distribution of scratch-off tickets. Sci Games receives 1.40% of net scratch-off ticket revenue. Effective August 1, 2005, the contract was amended to reduce the commission Sci Games receives to 1.3855%.

Prize Expense—Prize expense for scratch-off and pull-tab games is recognized based on the predetermined prize structure of each game. Generally, prize expense for the on-line draw games is recognized based on the estimated payout experience for the respective game.

Budget—As stated in the Lottery Article, the Commission shall submit a detailed budget to the Budget Agency and each legislative member of the budget committee, when requested by the Agency, on forms prescribed by the Budget Agency. The budget committee has not requested a budget to date; however, the Commission prepares an annual budget that is reviewed and approved by the Executive Director for internal purposes. The Commission is not required to adopt a legal budget and does not do so; therefore, no budgetary comparison is included in these financial statements.

Effective July 1, 2005, the Lottery Article was amended and removed the Commission's responsibility to submit a detailed budget to the Budget Agency and each legislative member of the budget committee. The Commission continues to prepare an annual budget for internal purposes that is reviewed and approved by the Executive Director.

New Accounting Pronouncements—Effective July 1, 2005, the Commission adopted the provisions of GASB issued Statement on Government Accounting Standards (“SGAS”) No. 42, *Accounting and Reporting for Impairment of Capital Assets and Insurance Recoveries*, which establishes accounting and financial reporting standards for impairment of capital assets. In accordance with this statement a capital asset will be considered impaired when its service utility has declined significantly and unexpectedly and such impairment will be required to be reported in the financial statements when such impairment has occurred and not as part of ongoing depreciation or upon disposal of the capital asset. This statement also enhances comparability of financial statements between governments by requiring all governmental entities to account for insurance recoveries in the same manner. The adoption of SGAS No. 42 did not have an impact on the Commission’s financial statements.

Effective July 1, 2005, the Commission adopted the provisions of GASB issued SGAS No. 46, *Net Assets Restricted by Enabling Legislation*, which provides clarification of the requirements initially established by SGAS No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*. SGAS No. 34 requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets. This statement clarifies that a legally enforceable enabling legislation restriction is one that a party external to a government—such as citizens, public interest groups, or the judiciary—can compel a government to honor. The statement states that the legal enforceability of an enabling legislation restriction should be reevaluated if any of the resources raised by the enabling legislation are used for a purpose not specified by the enabling legislation or if a government has other cause for reconsideration. This statement specifies the accounting and financial reporting requirements if new enabling legislation replaces existing enabling legislation or if legal enforceability is reevaluated. This statement also requires governments to disclose the portion of total net assets that is restricted by enabling legislation. The adoption of SGAS No. 46 did not have an impact on the Commission’s financial statements.

Effective July 1, 2005, the Commission adopted the provisions of GASB issued SGAS No. 47, *Accounting for Termination Benefits*, which establishes accounting and financial reporting standards for termination benefits to be received as part of a voluntary or involuntary termination. The statement defines voluntary and involuntary termination and provides the appropriate accounting treatment based on the applicable type of termination. This statement requires that the effects of a termination benefit on an employer’s obligation for a defined benefit plan be accounted for and reported under SGAS No. 27, *Accounting for Pensions by State and Local Governmental Employers*, or SGAS No. 45, *Accounting and Financial Reporting by Employers for Postretirement Benefits Other than Pension*, as applicable. This statement requires employers to disclose a description of the termination benefit arrangement, the cost of the termination benefits, and significant methods and assumptions used to determine the termination benefit liability. The adoption of SGAS No. 47 did not have an impact on the Commission’s financial statements.

3. DEPOSITS AND INVESTMENTS

The Commission applies SGAS No. 40, *Deposits and Investments*, which provides guidance on disclosure information relating to investment credit risk, investment maturity information, interest rate sensitivity and foreign exchange exposure.

Deposits—The Commission’s investment policy establishes cash and investment guidelines for the deposit of funds. The Commission is authorized to make deposits in commercial banks, savings and loan institutions, obligations of the U.S. Treasury and U.S. Agencies, money market funds with portfolios of securities issued or guaranteed by the United States of America or agreements to repurchase these same obligations, repurchase agreements, and short-term commercial paper rated AAA or AA.

The carrying amount of the Commission's deposits with financial institutions at June 30, 2006 and 2005, totaled \$(895,310) and \$(1,726,396), respectively, while bank balances totaled \$43,693 and \$267,664, respectively. The bank balances are categorized as follows:

	2006	2005
Insured by the FDIC or collateralized with securities held by the Commission in its name	\$ 43,693	\$ 103,481
Uncollateralized or uninsured		<u>164,183</u>
Total deposits	<u>\$ 43,693</u>	<u>\$ 267,664</u>

The insured, collateralized, and the uninsured, uncollateralized cash balances carried during the year represent the compensating balances that are required to be maintained at banks in exchange for goods received or services provided.

Investments—The Lottery Article states that money that the Commission anticipates will be available for the payment of prizes on a deferred basis may be invested in direct U.S. Treasury obligations or insurance annuities. Investments are reported at fair value, except for insurance annuities, using quoted market prices. Insurance annuities are carried at cost. Changes in the fair value of the investments are recognized as nonoperating revenue or expense in the statements of revenues, expenses and changes in net assets. The net (decrease) increase in the fair value of U.S. treasury obligations for the years ended June 30, 2006 and 2005 was \$(3,730,714) and \$2,552,513, respectively. Investments in insurance annuity contracts, at rates yielding approximately 3% to 6%, relate to deferred prize obligations.

As of June 30, 2006, the Commission had the following investments and maturities:

	Fair Value	Investment Maturities (in Years)			
		< 1 Year	1–5 Years	6–10 Years	> 10 Years
U.S. government securities	\$ 34,460,432	\$ 2,660,690	\$ 9,385,385	\$ 9,286,630	\$ 13,127,727
Commercial paper	64,701,289	64,701,289			
Repurchase agreements	412,696	412,696			
Money market funds	<u>14,036,725</u>	<u>14,036,725</u>			
	113,611,142	81,811,400	9,385,385	9,286,630	13,127,727
	Carrying Value				
Insurance annuities	<u>38,453,523</u>	<u>4,046,242</u>	<u>14,791,090</u>	<u>11,111,669</u>	<u>8,504,522</u>
Total investments	<u>\$ 152,064,665</u>	<u>\$ 85,857,642</u>	<u>\$ 24,176,475</u>	<u>\$ 20,398,299</u>	<u>\$ 21,632,249</u>

As of June 30, 2005, the Commission had the following investments and maturities:

	Fair Value	Investment Maturities (in Years)			
		< 1 Year	1–5 Years	6–10 Years	> 10 Years
U.S. government securities	\$ 47,475,644	\$ 13,296,073	\$ 9,173,484	\$ 9,540,520	\$ 15,465,567
Commercial paper	8,665,323	8,665,323			
Repurchase agreements	425,093	425,093			
Money market funds	<u>42,937,708</u>	<u>42,937,708</u>			
	99,503,768	65,324,197	9,173,484	9,540,520	15,465,567
	Carrying Value				
Insurance annuities	<u>40,570,396</u>	<u>4,046,242</u>	<u>14,791,090</u>	<u>12,144,606</u>	<u>9,588,477</u>
Total investments	<u>\$ 140,074,164</u>	<u>\$ 69,370,439</u>	<u>\$ 23,964,574</u>	<u>\$ 21,685,126</u>	<u>\$ 25,054,044</u>

A reconciliation of cash, cash equivalents, and investments per the balance sheet to the deposits and investments previously presented is as follows as of June 30:

	2006	2005
Balance Sheet:		
Cash and cash equivalents	\$ 77,842,704	\$ 57,834,783
Investments (current)	7,024,000	9,668,378
Investments (long-term)	65,889,955	70,419,514
Restricted assets *	<u>412,696</u>	<u>425,093</u>
Total	<u>\$ 151,169,355</u>	<u>\$ 138,347,768</u>
Notes to the Financial Statements:		
Deposits	\$ (895,310)	\$ (1,726,396)
Investments (current and long-term)	<u>152,064,665</u>	<u>140,074,164</u>
Total	<u>\$ 151,169,355</u>	<u>\$ 138,347,768</u>

* included as a component of the restricted assets balance in the accompanying statements of net assets.

The following table provides information on the credit ratings associated with the Commission's investments as of June 30, 2006:

	S&P	Fitch	Moody's	A.M. Best	Balance at June 30, 2006
U.S. government securities	unrated	unrated	unrated	unrated	\$ 34,460,432
Commercial paper	A1+	F1+	P1	unrated	64,701,289
Repurchase agreements	unrated	unrated	unrated	unrated	412,696
Money market funds	AAAm	AAA	Aaa	unrated	14,036,725
Insurance company (annuities)	AA	AA+	Aa3	A+	<u>38,453,523</u>
Total investments					<u>\$ 152,064,665</u>

The Commission is not limited on the amount it can invest in one issuer. More than 5% of the Commission's investments are in United States Treasury Strips, Citigroup Funding Commercial Paper, Key Bank Prime Money Market Fund and AGEON Institutional Markets annuities. These investments are 22.66%, 42.55%, 9.23% and 25.29%, respectively, of the Commission's total investments.

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Commission will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The \$152 million of investments is not held by the Commission. Investments totaling \$34 million are held by the treasurer of the state; therefore, these investments are not considered to have custodial credit risk. The remaining \$118 million of investments are held by an outside counterparty.

4. CAPITAL ASSETS

A summary of the Commission's capital assets at June 30, 2006 and 2005 is as follows:

	Balances at June 30, 2005	Increases	Decreases	Balances at June 30, 2006
Vehicles	\$ 2,021,714	\$ 225,968	\$ (497,618)	\$ 1,750,064
Furniture, fixtures, and equipment	6,490,364	373,017	(143,933)	6,719,448
Data processing equipment	<u>4,032,912</u>	<u>490,332</u>	<u> </u>	<u>4,523,244</u>
Total capital assets— being depreciated	<u>12,544,990</u>	<u>1,089,317</u>	<u>(641,551)</u>	<u>12,992,756</u>
Less accumulated depreciation:				
Vehicles	(1,235,692)	(286,593)	466,582	(1,055,703)
Furniture, fixtures, and equipment	(4,926,872)	(679,466)	135,716	(5,470,622)
Data processing equipment	<u>(3,388,124)</u>	<u>(271,677)</u>	<u> </u>	<u>(3,659,801)</u>
Total accumulated depreciation	<u>(9,550,688)</u>	<u>(1,237,736)</u>	<u>602,298</u>	<u>(10,186,126)</u>
Total capital assets—net	<u>\$ 2,994,302</u>	<u>\$ (148,419)</u>	<u>\$ (39,253)</u>	<u>\$ 2,806,630</u>

	Balances at June 30, 2004	Increases	Decreases	Balances at June 30, 2005
Vehicles	\$ 2,043,017	\$ 86,881	\$ (108,184)	\$ 2,021,714
Furniture, fixtures, and equipment	7,060,682	53,956	(624,274)	6,490,364
Data processing equipment *	<u>7,878,698</u>	<u>556,864</u>	<u>(4,402,650)</u>	<u>4,032,912</u>
Total capital assets— being depreciated	<u>16,982,397</u>	<u>697,701</u>	<u>(5,135,108)</u>	<u>12,544,990</u>
Less accumulated depreciation:				
Vehicles	(1,020,220)	(313,110)	97,638	(1,235,692)
Furniture, fixtures, and equipment	(4,839,387)	(702,293)	614,808	(4,926,872)
Data processing equipment *	<u>(7,160,338)</u>	<u>(589,336)</u>	<u>4,361,550</u>	<u>(3,388,124)</u>
Total accumulated depreciation	<u>(13,019,945)</u>	<u>(1,604,739)</u>	<u>5,073,996</u>	<u>(9,550,688)</u>
Total capital assets—net	<u>\$ 3,962,452</u>	<u>\$ (907,038)</u>	<u>\$ (61,112)</u>	<u>\$ 2,994,302</u>

* The Commission wrote off \$3,908,677 of fully depreciated capital assets during 2005.

5. PRIZE LIABILITY

The prize liability relating to past game show and on-line winners, including an estimate of unclaimed instant and on-line winners at June 30, 2006 and 2005 is as follows:

	2006	2005
TV game show and Hoosier Lotto liability	\$ 74,536,080	\$ 75,071,819
Scratch game liability	42,563,908	38,352,981
Pull tab game liability	1,795,367	1,832,925
On-line game liability	6,409,142	7,992,177
Unclaimed prize liability	<u>275,088</u>	<u>440,167</u>
Total prize liability	125,579,585	123,690,069
Less current portion	<u>(58,067,505)</u>	<u>(55,459,250)</u>
Noncurrent portion	<u>\$ 67,512,080</u>	<u>\$ 68,230,819</u>

Future payments of prize liability as of June 30, 2006, are as follows:

Fiscal Years Ending June 30	TV Game Show and Hoosier Lotto	Other Accrued Prize Liability	Total
2007	\$ 7,024,000	\$ 51,043,505	\$ 58,067,505
2008	7,024,000		7,024,000
2009	7,024,000		7,024,000
2010	7,024,000		7,024,000
2011	7,024,000		7,024,000
2012–2016	30,110,000		30,110,000
2017–2021	27,400,000		27,400,000
2022–2026	16,794,000		16,794,000
2027–2030	<u>3,477,000</u>		<u>3,477,000</u>
Total	112,901,000	51,043,505	163,944,505
Less unamortized discount	<u>(38,364,920)</u>		<u>(38,364,920)</u>
Total at present value	74,536,080	51,043,505	125,579,585
Less current portion	<u>(7,024,000)</u>	<u>(51,043,505)</u>	<u>(58,067,505)</u>
Total long-term portion at present value	<u>\$ 67,512,080</u>	<u>\$</u>	<u>\$ 67,512,080</u>

Prize liability installments are discounted to their present value at date of award. This discounted value approximates fair value. Interest is not paid on prizes.

6. OPERATING LEASES

The Commission leases office space, under noncancelable operating leases, in each of its seven regions and at headquarters located in Indianapolis under initial lease terms of one to 10 years, warehouse space for its ticket inventory, and parking facilities for the Indianapolis location. The Commission also leases office equipment on terms ranging from two to five years, including a scratch-off ticket vending machine lease. Total rental expense was \$3,056,535 and \$2,814,064 for the years ended June 30, 2006 and 2005, respectively.

The future minimum rental payments required under noncancelable operating leases with original terms in excess of one year are as follows:

**Fiscal Years Ending
June 30**

2007	\$ 723,278
2008	636,276
2009	576,900
2010	565,524
2011	547,524
2012-2015	<u>770,793</u>
Total	<u>\$ 3,820,295</u>

7. COMMITMENTS AND CONTINGENCIES

Commitments—The Commission is a member of the Multi-State Lottery Association (“MUSL”), an unincorporated government-benefit voluntary association created for the purpose of administering joint lottery games. MUSL currently consists of 31 state and district lotteries (“member lotteries”) and operates the on-line Powerball game. Under separate agreements between MUSL and each lottery, the member lotteries sell tickets for this game and remit 50% of sales to prize winners or to MUSL for payment of prizes.

As a member of MUSL, the Commission is required to contribute to various prize reserve funds held by MUSL. Accounts were established by MUSL as a contingency reserve to fund prizes in excess of the game prize structure and to protect all member lotteries and MUSL from any unforeseen liabilities. All funds remitted, and the related interest earned, will be returned to the Commission upon leaving MUSL, less any portion of unanticipated prize claims that may have been paid from the funds. As of June 30, 2006 and 2005, the Commission’s balance of prize reserve funds, included in restricted assets in the accompanying statement of net assets, was \$8,580,027 and \$8,799,662, respectively.

Restricted assets also contain the Retailers Bonding Fund, with a balance as of June 30, 2006 and 2005, of \$412,696 and \$425,093, respectively.

Litigation—Periodically, the Commission is subject to certain legal and administrative actions that arise in the normal course of its operations. As of June 30, 2006, the Commission’s management believes that the ultimate outcome of any pending legal matters will not have a material adverse impact on the Commission’s financial position.

8. RETIREMENT PLANS

Deferred Compensation Plan—The Commission offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all employees, allows an employee to contribute a minimum of \$15 per paycheck or 1% of eligible earning (percentage withholding must equal at least \$15) and a maximum of 100% of includible compensation (subject to Internal Revenue Service limitations). Employees are immediately vested in their contributions. Contributions by plan participants during the fiscal years ended June 30, 2006 and 2005 were approximately \$251,000 and \$303,000, respectively.

The Commission makes a matching contribution of \$15 per paycheck for each employee participating in the 457 Deferred Compensation Plan into a 401(a) Incentive Match Plan. Employees are immediately vested in the employer match made by the Commission. Contributions by the Commission during the fiscal years ended June 30, 2006 and 2005 were approximately \$39,000 and \$61,000, respectively.

Defined Benefit Pension Plan—The Commission has adopted a single-employer defined benefit pension plan. Article 30 of the state statute of Indiana assigns the Commission to establish and amend benefit provisions. An independent contractor administers the Employees' Pension Plan of the State Lottery Commission of Indiana (the "Plan"). The Plan covers virtually all of the Commission's full time employees over the age of 21, providing retirement, death, and disability benefits. Upon employee retirement at age 65, the Plan provides annual benefits equal to 2% of an employee's average salary earned during the highest five consecutive years of employment multiplied by the number of full-time years of employment up to a maximum of 25 years. Participants become fully vested after four years of service. Employees cannot contribute to the plan, thus there is no required contribution for active plan members.

The Commission applies Governmental Accounting Standards Board Statement ("GASB") No. 27, *Accounting for Pensions by State and Local Governmental Employers*. GASB No. 27, which requires that the measurement of pension expense for a period be similar to the required contributions for that period and related information reported be consistent. The resulting pension asset required to comply with the provisions of GASB No. 27 was determined in accordance with this statement and is included in other accrued expenses in the statement of net assets.

The Commission's annual pension cost and net pension obligation to the Plan for the plan year ended December 31, 2005, 2004, and 2003, is as follows:

	2005	2004	2003
Annual required contribution	\$ 887,737	\$ 719,136	\$ 693,040
Interest on net pension obligation	(8,829)	(9,129)	(7,491)
Adjustment to annual required contribution	<u>(12,452)</u>	<u>(12,875)</u>	<u>(10,564)</u>
Annual pension cost	891,360	722,882	696,113
Contributions made	<u>(1,991,460)</u>	<u>(719,136)</u>	<u>(716,590)</u>
(Decrease) increase in net pension obligation	(1,100,100)	3,746	(20,477)
Net pension asset—beginning of year	<u>(110,367)</u>	<u>(114,113)</u>	<u>(93,636)</u>
Net pension asset—end of year	<u>\$ (1,210,467)</u>	<u>\$ (110,367)</u>	<u>\$ (114,113)</u>
Percentage of annual pension cost contributed	224.3 %	100.0 %	103.4 %

The annual required contribution and contribution rate for the current year was determined as part of the January 1, 2006 actuarial valuation using the frozen entry age actuarial cost method. The employer rate for calendar year 2005 was 9.5% of payroll. The actuarial assumptions included an 8.0% investment rate of return and a 4.0% increase in salary, post-retirement benefit increases or inflation components. The amortization method used is a level percentage of projected payroll on a closed basis over 30 years. The actuarial value of assets was determined using market value.

As of January 1, 2006, the Commission has an unfunded actuarial accrued liability of \$451,349. The Commission made a one-time payment of \$1,430,839 in June 2005 to fund the unfunded pension liability. This amount is included in prepaid expenses on the statement of net assets as of June 30, 2006 and is being amortized ratably over a ten year period in the statement of revenues, expenses and changes in net assets.

Effective July 1, 2006, the Commission made amendments to the Plan, including an amendment to change the Plan year to coincide with the Commission's fiscal year-end.

The Commission's six-year trend information, by Plan year, is as follows:

Plan Year	Annual Required Contribution	Actual Employer Contribution	Percentage Contributed	Net Pension Asset
2000	\$ 604,680	\$ 608,300	100.6 %	\$ (23,439)
2001	589,280	608,300	103.2	(41,689)
2002	599,280	652,596	108.9	(93,636)
2003	693,040	716,590	103.4	(114,113)
2004	719,136	719,136	100.0	(110,367)
2005	887,737	1,991,460	224.3	(1,210,467)

* * * * *

REQUIRED SUPPLEMENTARY INFORMATION

THE STATE LOTTERY COMMISSION OF INDIANA

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF FUNDING PROGRESS FOR PENSION PLAN

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuary Accrued Liability (AAL) Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
1/1/2000	\$4,987,986	\$ 5,000,399	\$ 12,413	99.8 %	\$ 7,204,319	0.2 %
1/1/2001	5,958,506	7,367,872	** 1,409,366	80.9	7,595,329	18.6
1/1/2002	6,922,670	8,308,021	1,385,351	83.3	8,072,437	17.2
1/1/2003	7,650,486	* 9,012,069	1,361,583	* 84.9	* 8,770,313	* 15.5
1/1/2004	7,673,634	9,362,428	1,688,794	82.0	8,395,882	20.1
1/1/2005	8,254,981	9,909,288	1,654,307	*** 83.3	9,302,333	17.8
1/1/2006	9,146,422	9,597,771	451,349	95.3	6,676,472	6.8

* Revised figures reflect a difference between the final 2002 contribution and the contribution that was expected at the time the January 1, 2003, valuation was completed.

** Increase in Actuary Accrued Liability (AAL) Entry Age (b) due to change in vesting schedule.

*** The Commission made a one-time payment of \$1,430,839 in June 2005 to fund the unfunded pension liability.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the State Lottery Commission of Indiana:

We have audited the financial statements of the State Lottery Commission of Indiana ("Commission") as of and for the years ended June 30, 2006 and 2005, and have issued our report thereon dated October 11, 2006. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Commission's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Commission's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed one instance of noncompliance or other matters that are required to be reported under *Government Auditing Standards* which is described in the accompanying Schedule of Findings and Responses as item 1.

We noted certain other matters that we reported to management of the Commission in a separate letter dated October 11, 2006.

This report is intended solely for the information and use of the State Lottery Commission of Indiana and management and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLP

October 11, 2006

THE STATE LOTTERY COMMISSION OF INDIANA

SCHEDULE OF FINDINGS AND RESPONSES FOR THE YEAR ENDED JUNE 30, 2006

ITEM 1

Finding

Indiana Code, Article 30-16-1, allows the Commission to keep an amount necessary to pay prizes, pay expenses for the operation of the Commission, compensate retailers, and costs of supplies, materials, tickets, etc. According to IC 4-30-16-3(c), the surplus revenue remaining in the fund on the last day of January, April, July and October after the transfers under subdivisions a) and b) shall be transferred by the commission to the treasurer of state for deposit on that day in the Build Indiana Fund. Thus, any surplus over and above what the Commission deems necessary to pay prizes and for general and administrative expenses is to be turned over to the State no later than the last day of the month following the quarters end. We noted during our testing of the Commission's compliance with Indiana statutes that the Commission did not remit its second and third quarter surplus to the State by the last day of January and April 2006, respectively. The payments were remitted to the State on February 3, 2006 and May 1, 2006.

Response

The January 31, 2006 payment of surplus revenue to the State Treasurer was sent three days late on February 3, 2006. This late payment was the result of an oversight on the Commission's part. The April 30, 2006 payment was initially sent on April 30, 2006 but was returned. Unbeknownst to the Lottery, due to a change in payment method, the State Treasurer's account information changed. As soon as the Lottery was notified of the proper account information on May 1, 2006, the payment was sent. In both cases the funds remained in the Lottery's investment account and continued to earn interest. Therefore, there was no loss of income to the State as the interest was included in the Lottery's next payment to the State.